REAL

Resources Inc.

1994 Annual Report

Corporate Profile

Real Resources Inc., ("Real" or "the Company") was incorporated in 1978 pursuant to the laws of Alberta and since 1989, Real's Common Shares have traded on The Alberta Stock Exchange under the symbol RER. At the end of 1994, the issued share capital of Real was 7,543,861 common shares. The Company's business is the acquisition of petroleum and natural gas rights and the exploration, development and production of oil and natural gas in Alberta and Saskatchewan. Real carries on business directly and through its wholly owned subsidiary, Blue Ridge Resources Inc. ("Blue Ridge"). Prior to September 21, 1994 Renaissance Energy Ltd. ("Renaissance") owned 1,197,500 (49%) of the Company's total issued and outstanding common shares. At that time all of the Company's reserves were proven and producing properties located in the Delia area of Alberta, and management functions of Real were performed by Renaissance under a management agreement which included provision for a fee equal to 10% of gross revenues.

On September 21, 1994 Renaissance sold its Real common shares to a number of individuals and the management agreement was terminated.

Corporate Expansion

On September 23, 1994, Real acquired Blue Ridge Resources Inc., a private Alberta oil and gas company, for cash and shares. The cash portion of Real's purchase of all shares was financed by the issuance of 3,500,000 common shares at $0.50/share.

The principal producing properties of Blue Ridge, at the time of acquisition by Real, were comprised of oil properties at Hays, Alberta and gas properties at Cactus Lake, Saskatchewan. Its assets included 5,100 kilometres of non-proprietary seismic and approximately 3,900 net acres of land.

Annual Meeting

The Annual General Meeting will be held at 1500 hrs. (Calgary time) on June 19, 1995 at the Cardium Room of the Calgary Petroleum Club, 319 - 5th Avenue S.W. Calgary, Alberta.

Shareholders are encouraged to attend and those unable to do so should complete the Form of Proxy and forward it at their earliest convenience.

Highlights

	1994	1993
Financial		
Petroleum and natural gas sales	205,841	95,179
Operating income	102,694	52,717
Cash flow from operations	12,545	23,218
– per share (basic)	–	0.01
Net income	(38,851)	12,718
– per share (basic)	(0.01)	0.01
Capital expenditures	203,505	–
Acquisition of subsidiary	2,147,229	–
Working capital	736,748	31,297
Long term debt	–	–
Number of common shares – at year end		
Basic	7,543,861	2,443,861
Fully diluted	8,123,861	2,443,861
Operating		
Working interest production		
Oil – Bbls/d	59	8
Gas – MCF/d	223	48
Barrels of oil equivalent – Boe/d	96	16
Average prices		
Oil – $/Bbl	19.38	18.07
Gas – $/MCF	1.83	2.52
Working interest reserves – proven		
Oil – MBbls	185	7
Gas – MMCF	977	70
Barrels of oil equivalent – MBoe	348	19
Land Holdings		
Gross Acres	22,633	800
Net Acres	3,799	336

Report to our Shareholders

Business Discussion

Real's production is balanced between oil and gas however, because of weak gas prices Real has been delayed in bringing shut-in gas reserves on stream. Most of the oil is produced at Hays, Alberta and the gas at Cactus Lake, Saskatchewan, where Real has an ownership position in a gas plant.

In January 1995, the first of two gas wells at McMullen, Alberta, came on stream with 100 Mcfpd net to Real. Also Real acquired ownership in additional Cactus Lake, Saskatchewan, properties with an effective date of January 1, 1995. At Evi, Alberta, the Company invested $200,000 in 2720 gross acres of land and technical data. Real anticipates participating in a multi-well exploration program planned for the 1995 year winter season. Recently, Real purchased a seven section licence in the Marten Hills area which is gas prone. As a result of these activities, the Company increased its land holdings from gross/net 22600/3800 acres at the end of 1994 to gross/net 27200/6350 acres at the end of March 1995.

On February 21, 1995, Blue Ridge exercised a pre-existing option to buy certain proprietary seismic from a director for consideration of 937,500 common shares of Real. This proprietary seismic has and is expected to generate significant seismic sale income to the Company.

The Company is negotiating various acquisitions to bolster its production. While providing a steady cashflow is a priority, the major thrust of Real will be to develop a long term exploration portfolio based on the Company's 5800 km. seismic data base. In order to achieve this, the Company plans to expand its exploration staff during second quarter of 1995.

Management Discussion and Analysis

Financial Resources and Capital Expenditures

At December 31, 1994 Real had a working capital balance of $736,748, an increase of $705,451 over 1993 levels. This increase arises from the excess of proceeds received from the sale of shares for cash and seismic rights over the cost of acquiring Blue Ridge and other capital expenditures.

At December 31, 1994 Real had no debt and our operating line of credit with a Canadian chartered bank was not utilized.

In 1994, Real's capital expenditures totalled $203,000 comprised of $102,000 for drilling and abandonment of a shallow gas well in Cactus Lake, $57,000 for satisfaction of a previous Blue Ridge obligation for geological and geophysical services provided to Blue Ridge, $36,000 for office furniture and equipment, and $8,000 for upgrades to the Cactus Lake 15–10 compressor.

Revenue and Expenses

Operating Income for 1994 was $102,694, an increase of $49,977 over 1993. This increase is due to the acquisition of Blue Ridge.

Administration expenses for 1994 were $94,301 an increase of $72,222 over 1993. The increase is attributable to costs associated with the administration of Blue Ridge operations as well as additional expenses to administer Real's operations previously handled by Renaissance. Management fees decreased $4,188 to $5,330 to reflect the termination of the management agreement with Renaissance in September, 1994. Depletion and depreciation for 1994 was $67, 516, an increase of $62,116 over 1993. The majority of this increase can be attributed to the acquisition of Blue Ridge with a small amount applicable to the depreciation of assets required to manage Real operations previously handled by Renaissance.

Outlook

For the remainder of 1995 Real expects a favourable environment which will enable Real to add selectively to its property base and position the Company for the future.

We would like to thank our Shareholders for their continuing support.

On behalf of the board

Frans Burger
President

Auditors' Report to the Shareholders

We have audited the consolidated balance sheets of Real Resources Inc. as at December 31, 1994 and 1993 and the consolidated statements of income (loss) and deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1994 and 1993 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

KPMG Peat Marwick Thorne

Chartered Accountants

Calgary, Canada
March 24, 1995

Consolidated Balance Sheets

December 31, 1994 and 1993

	1994	1993
Assets		
Current assets:		
Cash	$ 705,397	$ 222
Advances to related party (note 3)	–	48,194
Accounts receivable	176,314	–
Prepaid expenses	4,865	–
	886,576	48,416
Property, plant and equipment, at cost	2,229,980	317,188
Less accumulated depletion and depreciation	(375,783)	(308,267)
	1,854,197	8,921
	$ 2,740,773	$ 57,337
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 149,828	$ 17,119
Site Restoration accrual	49,580	14,000
Deferred taxes	63,998	–
Shareholders' equity:		
Share capital (note 4)	3,506,410	1,016,410
Deficit	(1,029,043)	(990,192)
	2,477,367	26,218
	$ 2,740,773	$ 57,337

See accompanying notes to consolidated financial statements.

On behalf of the Board:

Francois Burger, Director and President

Dallas L. Droppo, Director and
Secretary-Treasurer

Consolidated Statements of Income (Loss) and Deficit

Years ended December 31, 1994 and 1993

	1994	1993
Revenue:		
Petroleum and natural gas revenues	$ 205,841	$ 95,179
Royalties	(22,601)	(11,036)
Production expenses	(80,546)	(31,426)
	102,694	52,717
Other income	9,482	–
	112,176	52,717
Expenses:		
General and administrative	94,301	22,079
Management fee to related party (note 3)	5,330	9,518
Interest from related party (note 3)	–	(2,098)
Depletion and depreciation	67,516	5,400
Current site restoration provision	6,580	5,100
	173,727	39,999
Income (loss) before income taxes	(61,551)	12,718
Income taxes (note 5):		
Deferred (recovery)	(22,700)	–
Net income (loss)	(38,851)	12,718
Deficit, beginning of year	990,192	1,002,910
Deficit, end of year	$ 1,029,043	$ 990,192

Per share amounts (note 6).

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1994 and 1993

	1994	1993
Cash provided by (used in):		
Operations:		
Net income (loss)	$ (38,851)	$ 12,718
Add (deducted) items not affecting cash:		
Depletion and depreciation	67,516	5,400
Current site restoration provision	6,580	5,100
Deferred income taxes (recovery)	(22,700)	–
Cash flow from operations	12,545	23,218
Change in non-cash working capital	(46,636)	(23,803)
Cash available for investing activities	(34,091)	(585)
Financing:		
Shares issued:		
For cash	1,790,000	–
On acquisition of Blue Ridge Resources Inc.	700,000	–
	2,490,000	–
Investments:		
Additions to property, plant and equipment	(203,505)	–
Dispositions of property, plant and equipment	600,000	–
Acquisition of Blue Ridge Resources Inc. (note 2)	(2,147,229)	–
	(1,750,734)	–
Increase (decrease) in cash	705,175	(585)
Cash, beginning of year	222	807
Cash, end of year	$ 705,397	$ 222

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Years ended December 31, 1994 and 1993

1. **Significant accounting policies:**

(a) The financial statements include the accounts of Real Resources Inc. and its wholly-owned subsidiary Blue Ridge Resources Inc., effective from the date of acquisition, being September 23, 1994 (note 2).

(b) Property, plant and equipment:

(i) Capitalized costs:

The full cost method of accounting for petroleum and natural gas properties and related expenditures is followed. Under this method, all costs related to the exploration and development of petroleum and natural gas reserves are capitalized. Capitalized costs include those related to lease acquisitions, geological and geophysical activities, lease rentals on non-producing properties, and drilling of productive and non-productive wells. General and administrative and interest expenses are not capitalized.

Proceeds from the disposition of petroleum and natural gas properties are accounted as a reduction in capitalized costs, with no gain or loss recognized unless such disposition would alter the depletion and depreciation rate by 20% or more. Substantially, all exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Company's proportionate interest in such activities.

(ii) Depletion and depreciation:

Depletion of petroleum and natural gas properties and depreciation of production equipment and facilities are calculated on the unit-of-production method based upon

- total estimated proven developed and undeveloped reserves, before royalties, as determined by independent engineers;
- total capitalized costs plus estimated future development costs of proven undeveloped reserves (as determined by independent engineers) less estimated net realizable value of production equipment and facilities after the proven reserves are fully produced (as determined by management); and
- relative volumes of petroleum and natural gas reserves and production converted at the energy equivalent conversion ratio of six thousand cubic feet of natural gas to one barrel of crude oil.

(iii) Ceiling test:

The carrying amount of property, plant and equipment, net of the site restoration accrual, is limited to the sum of:
- estimated future net revenues from proven reserves based on year end prices, less development costs of proven undeveloped reserves, principally as determined by independent engineers.

Less management's year end estimate of future:
- site restoration costs;
- production-related general and administrative expenses;
- interest expense; and
- applicable income taxes.

Plus managementment's estimate of futture:
- net realizable value of production equipment and facilities.

No write-down of property, plant and equipment was required under the ceiling test in 1993 or 1994.

(b) Site restoration costs:

Management has prepared estimates for future site restoration costs based upon costs and regulations in effect at the end of the year. In accordance with generally accepted accounting principles, these costs will be expensed over the life of the remaining proven reserves. The current site restoration provision represents the annual recognition of such expense based upon the production volumes of that year. Site restoration accrual represents the aggregate of such annual provisions less the aggregate of actual site restoration expenditures incurred.

Notes to Consolidated Financial Statements Cont'd

2. Business acquisition:

Effective September 23, 1994, the Company acquired all of the outstanding shares of Blue Ridge Resources Inc. (Blue Ridge") for an aggregate consideration of $779,847, paid in cash, shares and a demand promissory note bearing interest at 8%. The acquisition was accounted for as a purchase and the purchase price has been allocated on fair value as follows:

Current assets	$ 356,352
Capital assets	2,309,287
	2,665,639
Less:	
Current liabilities	(402,712)
Site restoration accrual	(29,000)
Deferred incomes taxes	(86,698)
	2,147,229
Due to the Company prior to acquisition	(1,367,382)
	$ 779,847
Funded by:	
Cash	$ 837,500
Shares in the Company	700,000
Demand promissory note	600,000
Costs incurred	9,729
Total consideration	2,147,229
Less: Due from Blue Ridge	(1,367,382)
	$ 779,847

3. Related party transactions:

(a) The Company had contracted with Renaissance for the provision of management and administrative services for a fee equal to 10% of gross revenue. The agreement was terminated on September 21, 1994 when Renaissance sold their shares in the Company.

(b) During 1994, the Company sold proprietary seismic data to a director for $600,000 in satisfaction of the demand promissory note. On March 3, 1995 the Company exercised an option to re-acquire this data for a value of $600,000 to be settled with 937,500 common shares of the Company.

4. Share capital:

(a) Authorized:

The Company was continued under the laws of the Province of Alberta on January 11, 1989. The authorized share capital consists of an unlimited number of common shares without nominal or par value, and an unlimited number of each class of first, second, third and fourth preferred shares. No terms of conditions for the preferred shares have been set by the Board of Directors.

(b) Issued:

	Number of Shares	Amount
Balance, December 31, 1993 and 1992	2,443,861	$ 1,016,410
Private placements	3,700,000	1,790,000
Purchase of Blue Ridge	1,400,000	700,000
Balance, December 31, 1994	7,543,861	$ 3,506,410

(c) The following options to purchase common shares are outstanding:

Number of Shares	Exercise Price	Expiry Date
120,000	$ 0.20	Sept. 21, 1999
460,000	$ 0.50	Sept. 23, 1999

Notes to Consolidated Financial Statements Cont'd

5. Income taxes:

The provision for income taxes in the statement of income (loss) reflects an effective income tax rate which differs from combined federal and provincial statutory tax rates. The main differences are summarized as follows:

	1994	1993
Income (loss) before income taxes	$ (61,551)	$ 12,718
Corporate income tax rate	44.3%	44.3%
Computed income tax provision (recovery)	(27,300)	5,600
Increase (decrease) resulting from:		
Non-deductible Crown payments, net	8,200	4,700
Resource allowance	(3,600)	(3,600)
Accounting losses for income tax purposes utilized	–	(6,700)
	4,600	(5,600)
Actual income tax provision (recovery)	$ (22,700)	$ –

The Corporation has available for deduction against future taxable income undepreciated capital cost, Canadian exploration expense, Canadian development expense and Canadian oil and gas property expense aggregating approximately $949,000 (1993 – $714,000) some of which may be restricted and be deductible only against revenues from certain properties.

6. Earnings (loss) per share:

	Basic and fully diluted 1994	1993
Earnings (loss) per share:		
– basic	$ (.01)	$ .01
– fully diluted	$ (.01)	$ .01
Weighted average number of shares outstanding:		
– basic	3,482,217	2,443,861
– fully diluted	4,001,779	2,443,861

Corporate Directory

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Dallas L. Droppo
Ted W. Hamilion

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Harvey R. Pederson, Vice President Operations
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Dallas L. Droppo, Secretary

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Stock Exchange
ALBERTA STOCK EXCHANGE
Trading Symbol: RER

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